IN THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF TENNESSEE

In re

Case No. 03-30431

MARGARET A. BOHLING

Debtor

ANN MOSTOLLER, TRUSTEE

Plaintiff

v. Adv. Proc. No. 03-3187

AMERICAN HONDA FINANCE CORPORATION

Defendant

MEMORANDUM ON MOTIONS FOR SUMMARY JUDGMENT

APPEARANCES: LITTLE & MILLIGAN, P.L.L.C.
F. Scott Milligan, Esq.
900 East Hill Avenue
Suite 130
Knoxville, Tennessee 37915
Attorneys for Plaintiff, Ann Mostoller, Trustee

HODGES, DOUGHTY & CARSON, PLLC
Thomas H. Dickenson, Esq.
Post Office Box 869
Knoxville, Tennessee 37901-0869
Attorneys for Defendant, American Honda Finance Corporation

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

This adversary proceeding is before the court upon the Complaint filed by the Plaintiff, Ann Mostoller, Chapter 7 Trustee, on October 31, 2003, seeking to avoid the lien of the Defendant, American Honda Finance Corporation, on the Debtor's automobile pursuant to 11 U.S.C.A. § 549(a) (West 1993). A trial is scheduled for May 4, 2004.

Presently before the court are (1) the Motion for Summary Judgment filed by the Trustee on March 8, 2004; and (2) the Motion for Summary Judgment filed by the Defendant on April 2, 2004. The Motions are supported by Memoranda of Law as required by E.D. Tenn. LBR 7007-1, along with the Statement of Undisputed Material Facts filed by the Trustee on March 8, 2004, the Affidavit of Ann Mostoller, the Affidavit of Nina Potter, Title Clerk with Airport Honda, Inc., and the exhibits attached to these documents. Additionally, at the request of the Defendant, the court takes judicial notice of certain undisputed facts of record in the Debtor's Chapter 7 bankruptcy case file. *See* FED. R. EVID. 201(d).

This is a core proceeding. 28 U.S.C.A. § 157(b)(2)(K) (West 1993).

I

The following facts are not in dispute. On September 9, 2002, the Debtor purchased a new 2002 Honda Accord (Automobile) from Airport Honda, Inc. (Dealership) and pursuant thereto, she executed an Automobile - Simple Interest Retail Installment Contract - Consumer Credit Document Tennessee (Contract). The Debtor financed the purchase price of the Automobile through a loan from the Defendant, which was secured by a lien against the Automobile. The Dealership duly filed an Application for Certificate of Title and Registration

with the State of Tennessee and the Defendant's lien was thereafter noted on the Certificate of Title issued on September 16, 2002 (Original Certificate of Title). However, the Original Certificate of Title incorrectly listed the registered owner of the Automobile as "Margaret A. Bowling."

The incorrect spelling of the Debtor's name was discovered on January 27, 2003, and Ms. Potter, a Title Clerk with the Dealership, faxed a letter to the Defendant, requesting the return of the Original Certificate of Title in order to correct the error. Although not requested to do so, the Defendant released its lien on the Certificate of Title on January 30, 2003, and delivered the title to Ms. Potter. After Ms. Potter received the Original Certificate of Title, she prepared paperwork, including a new Application for Certificate of Title and Registration (Application), dated February 5, 2003, which, together with the Original Certificate of Title, was forwarded to the State of Tennessee in order to obtain a new title containing the correct spelling of the Debtor's name. On February 24, 2003, the State of Tennessee issued another Certificate of Title with the Debtor's correct last name noted (Revised Certificate of Title). Pursuant to the February 5, 2003 Application, the Defendant was again noted as the first lienholder on the Automobile.

Unbeknownst to the Defendant or the Dealership, the Debtor filed the Voluntary Petition commencing her Chapter 7 bankruptcy case on January 30, 2003, and the Plaintiff was duly appointed trustee. The Debtor listed the Defendant on her Schedule D - Creditors Holding Secured Claims, stating that the Defendant held a claim on the Automobile in the amount of $18,200.00, of which $16,000.00 was secured and $2,200.00 was unsecured. The

Defendant filed a secured Proof of Claim on April 2, 2003, in the amount of $17,323.99. As proof of its security interest in the Automobile, the Defendant attached a copy of the Contract and the Revised Certificate of Title.

The Trustee filed the Complaint initiating this adversary proceeding, based upon the voluntary post-petition release of the Defendant's lien on the Original Certificate of Title and the subsequent post-petition perfection of its lien on the Revised Certificate of Title. She avers that the Defendant's lien, while property perfected at the time the Original Certificate of Title was issued, was released by the Defendant, thus making the Defendant's post-petition notation of its lien on the Revised Certificate of Title invalid under § 549 and thereby avoidable. On the other hand, the Defendant argues that it executed the Release of Lien on the Original Certificate of Title for the sole purpose of correcting the error to the Debtor's name and that its security interest in the Automobile remained throughout the correction process with the State of Tennessee. The Defendant also argues that the post-petition issuance of the Revised Certificate of Title in no way depleted the Debtor's estate, which is the purpose behind § 549. Finally, the Defendant avers that all parties involved, including the Debtor, were aware that the lien had not been satisfied, and as such, under either the earmarking doctrine or the doctrine of mutual mistake, the Trustee is not entitled to avoid the lien noted on the Revised Certificate of Title obtained on February 5, 2003.

II

Summary judgment is governed by Federal Rule of Civil Procedure 56, made applicable to adversary proceedings through Rule 7056 of the Federal Rules of Bankruptcy Procedure. Rule 56 dictates that summary judgment "shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." FED. R. CIV. P. 56(c).

The moving party bears the initial burden of proving that there are no genuine issues of material fact, entitling it to judgment as a matter of law. *Owens Corning v. Nat'l Union Fire Ins. Co.*, 257 F.3d 484, 491 (6th Cir. 2001). The burden then shifts to the nonmoving party to produce specific facts showing a genuine issue for trial. *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 106 S. Ct. 1348, 1356 (1986) (citing FED. R. CIV. P. 56(e)). The nonmoving party must cite specific evidence and may not merely rely upon allegations contained in the pleadings. *Harris v. Gen. Motors Corp.*, 201 F.3d 800, 802 (6th Cir. 2000). The facts and all resulting inferences will be viewed in the light most favorable to the non-moving party. *See Matsushita*, 106 S. Ct. at 1356. The court must then decide whether "the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law." *Anderson v. Liberty Lobby, Inc.*, 106 S. Ct. 2505, 2512 (1986).

In this case, both of the parties have alleged that there are no genuine issues of material fact, and the court agrees. Therefore, the question before the court, based upon the facts and the exhibits in the record, is whether the Trustee or the Defendant is entitled to judgment as a matter of law.

III

The filing of a voluntary petition under Chapter 7 of the Bankruptcy Code constitutes an order for relief and creates a debtor's bankruptcy estate. *See* 11 U.S.C.A. § 301 (West 1993); 11 U.S.C.A. 541(a) (West 1993) ("The commencement of a case under section 301 . . . of this title creates an estate."). Additionally,

> (a) . . . [A] petition filed under section 301 . . . of this title . . . operates as a stay, applicable to all entities, of—
>
> . . . .
>
> (4) any act to create, perfect, or enforce any lien against property of the estate; [or]
>
> (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title[.]

11 U.S.C.A. § 362(a) (West 1993 & Supp. 2004).[1]

[1] An exception to this prohibition on post-petition perfection of a security interest is found in 11 U.S.C.A. § 362(b)(3) (West 1993 & Supp. 2004), which allows perfection of a lien or continuation of perfection if it occurs within the time allowed under state law, *see* 11 U.S.C.A. § 546(b) (West 1993 & Supp. 2004), or within ten days of the date upon which the security interest was granted, *see* 11 U.S.C.A. § 547(e)(2)(A) (West 1993 & Supp. 2004). In this case, however, there is no dispute that the security interest was granted on September 9, 2002, far outside the scope of either exception.

The avoidance of post-petition transfers is governed by § 549, which provides, in material part, that "the trustee may avoid a transfer of property of the estate . . . that occurs after the commencement of the case; and . . . is not authorized under this title or by the court." 11 U.S.C.A. § 549(a) (West 1993); *see also Pardo v. NYLCare Health Plans, Inc. (In re APF Co.)*, 274 B.R. 408, 418 (Bankr. D. Del. 2001) ("In order to meet the required elements of a § 549 transaction, a plaintiff must prove (1) that property of the estate (2) was transferred (3) after the filing of a petition and that such transfer (4) was not authorized by the Code or the Court."). While a trustee generally bears the burden of proof in avoidance actions, in cases involving post-petition transfers, the party asserting the validity of the transfer must prove its validity by a preponderance of the evidence. FED. R. BANKR. P. 6001; *Malloy v. St. John Med. Ctr. (In re Woodward)*, 234 B.R. 519, 523 (Bankr. N.D. Okla. 1999).

There is no dispute that the Automobile is property of the Debtor's bankruptcy estate and that the Revised Certificate of Title was applied for and issued by the State of Tennessee after the Debtor commenced her Chapter 7 bankruptcy case on January 30, 2003. Additionally, the court finds that the Defendant's lien perfected by notation on the Revised Certificate of Title was a transfer as contemplated by § 549, which includes "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption." 11 U.S.C.A. § 101(54) (West 1993 & Supp. 2004); *Hendon v. Gen. Motors Acceptance Corp. (In re B & B Utils., Inc.)*, 208 B.R. 417,

421 (Bankr. E.D. Tenn. 1997) (the creation of a lien constitutes a "transfer" under the Bankruptcy Code's definition).

Accordingly, the remaining § 549(a) question before the court is whether the notation of the Defendant's lien on the Revised Certificate of Title was authorized by the Bankruptcy Code or the court. Therefore, whether or not the Defendant was authorized to have the Revised Certificate of Title issued post-petition, without ramifications, balances on perfection of the Defendant's security interest as a matter of Tennessee law, as issues involving the method for achieving perfection of a security interest and the time at which a security interest is perfected are matters of state law. *B & B Utils.*, 208 B.R. at 421.

In Tennessee, perfection of a security interest in a motor vehicle is governed by Tennessee Code Annotated section 55-3-126, providing, in material part, that:

> (a) A lien or security interest in a vehicle of the type for which a certificate is required shall be perfected and shall be valid against subsequent creditors of the owner, subsequent transferees, and the holders of security interest and liens on the vehicle by compliance with this chapter.
>
> (b)(1) A security interest or lien is perfected by delivery to the division of motor vehicles or the county clerk of the existing certificate of title, if any, title extension form, or manufacturer's statement of origin and an application for a certificate of title containing the name and address of the holder of a security interest or lien with vehicle description and the required fee.
>
> (2) The security interest is perfected as of the date of delivery to the county clerk or the division of motor vehicles.
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> . . . .
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> (c) When the security interest is perfected as provided for in this section, it shall constitute notice of all liens and encumbrances against the vehicle

> described therein to creditors of the owner, to subsequent purchasers and encumbrances . . . .
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> (d) The method provided in this section and § 55-3-125 of obtaining a lien or encumbrance upon a motor vehicle . . . subject to the provisions of chapters 1-6 of this title relative to the issuance of certificates of title, shall be exclusive except as to liens depending upon possession and the lien of the state for taxes[.]

TENN. CODE ANN. § 55-3-126 (1998 & Supp. 2003). In other words, "a security interest in a motor vehicle is not perfected until a notation of the lien is made on the certificate of title." *Still v. First Tenn. Bank, N.A.*, 900 S.W.2d 282, 285 (Tenn. 1995).

The Defendant released its lien on January 30, 2003. The Application to correct the Original Certificate of Title was dated February 5, 2003, leaving a gap of six days in which the Defendant's lien on the Automobile was not properly perfected. On January 30, 2003, the Debtor filed her Voluntary Petition. Under Tennessee Code Annotated section 55-3-126(b)(2), had the Debtor not filed for bankruptcy, re-perfection of the Defendant's lien would have occurred on February 5, 2003, the date upon which it re-applied for notation of the lien with the State of Tennessee.[2] However, on January 30, 2003, when the Debtor filed her bankruptcy petition, the bankruptcy estate was created, the automatic stay went into effect, and the Defendant's February 5, 2003 perfection of its lien by notation on the Revised Certificate of Title was a post-petition transfer, avoidable under § 549(a)(1). *Accord Hildebrand v. Hays Imports, Inc. (In re Johnson)*, 279 B.R. 218, 220 n.5 (Bankr. M.D. Tenn.

[2] The Revised Certificate of Title was not issued by the State of Tennessee until February 24, 2003, but under Tennessee Code Annotated section 55-3-126(b)(2), the date of perfection relates back to February 5, 2003, the date upon which the Application was presented to either the Blount County Clerk or the State of Tennessee Department of Motor Vehicles.

2002) (stating that the post-petition perfection of an automobile lien is avoidable under § 549(a)).[3]

Moreover, because there was a gap in perfection, the Automobile became unencumbered after the commencement of the Debtor's bankruptcy case. As such, under Tennessee's statutory priority scheme, the Trustee obtained priority over the Defendant's unperfected security interest. *See* TENN. CODE ANN. § 47-9-102(a)(10) (2001) ("'Certificate of title' means a certificate of title with respect to which a statute provides for the security interest in question to be indicated on the certificate as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral.") *in accord with* TENN. CODE ANN. § 47-9-102(a)(52) (2001) ("'Lien creditor' means . . . (C) a trustee in bankruptcy from the date of the filing of the petition[.]").

The Defendant argues that when it released its lien on the Original Certificate of Title, it did so only to correct the misspelling of the Debtor's name. It did not intend to imply that the Debtor had satisfied the underlying debt, nor did the Debtor believe that the debt was satisfied. In fact, the Defendant argues that the Debtor was not even aware that the release had been executed and, based upon her bankruptcy schedules listing the Defendant's secured claim, as well as the fact that she reaffirmed the debt, the Defendant urges the court to apply

[3] The attempted perfection of the Defendant's lien on the Revised Certificate of Title also violated the automatic stay, and thus, is invalid and voidable. *See Easley v. Pettibone Mich. Corp.*, 990 F.2d 905, 911 (6th Cir. 1993); *see also Newton v. First Am. Nat'l Bank (In re Webb)*, 106 B.R. 517, 520 n.4 (Bankr. E.D. Tenn. 1989) (finding that a creditor's post-petition attempt to cure a clerical error on a certificate of title and to perfect its lien violated the automatic stay provisions of § 362(a)).

either the equitable defense of earmarking or the doctrine of mutual mistake in order to defeat the Trustee's avoidance action.

The "earmarking doctrine" is an equitable defense, wherein courts have declined to avoid transfers that technically meet the requirements of a preferential transfer under 11 U.S.C.A. § 547(b) (West 1993) if the bankruptcy estate was not diminished by the transfer. *See, e.g., Kaler v. Cmty. First Nat'l Bank (In re Heitkamp)*, 137 F.3d 1087 (8th Cir. 1998); *Gregory v. Cmty. Credit Co. (In re Biggers)*, 249 B.R. 873 (Bankr. M.D. Tenn. 2000); *Lancaster v. First Nat'l Bank of Greeneville, Tenn. (In re Cloyd)*, 23 B.R. 51 (Bankr. E.D. Tenn. 1982). The "earmarking doctrine" is generally applicable in cases concerning a refinance, but is not generally applicable when the creditor has simply failed to perfect under applicable law. *See Vieira v. Anna Nat'l Bank (In re Messamore)*, 250 B.R. 913, 917 (Bankr. S.D. Ill. 2000).

Similarly, the doctrine of mutual mistake may be applied in a case where a creditor who has mistakenly released a deed of trust or mortgage is granted an equitable lien over the subject real property, based upon "a mistake common to all the parties to the written contract or the instrument or in other words it is a mistake of all the parties laboring under the same misconception," including a belief by a debtor that a valid lien remains in effect. *See ORNL Fed. Credit Union v. Wilson (In re Wilson)*, 261 B.R. 664, 667 (Bankr. E.D. Tenn. 2001); *In re Tate*, No. 99-31027, 2000 Bankr. LEXIS 760, at *15-*16 (Bankr. E.D. Tenn. Mar. 2, 2000). However, as the court has recently explained, based upon the clear wording of Tennessee Code Annotated section 55-3-126(d), Tennessee law does not allow the requirements of this

statute to be supplemented by equitable defenses. *See Farmer v. LaSalle Bank (In re Morgan)*, 291 B.R. 795, 801-02 (Bankr. E.D. Tenn. 2003) (citing *Schulman v. Ford Motor Credit Co. (In re Leach)*, 206 B.R. 903, 905, 907 (Bankr. M.D. Tenn. 1997); *Waldschmidt v. Smith (In re York)*, 43 B.R. 36, 37 (Bankr. M.D. Tenn. 1984); *Keep Fresh Filters, Inc. v. Reguli*, 888 S.W.2d 437, 442 (Tenn. Ct. App. 1994)). While Tennessee courts frequently recognize equitable defenses concerning its real property recording statutes, the same does not hold true for its certificate of title statutes. *Morgan*, 291 B.R. at 801-02. Accordingly, the court cannot grant the Defendant's request that the court apply either the earmarking doctrine or the doctrine of mutual mistake to preserve its lien.

Assuming, *arguendo*, that the court did have the authority under Tennessee law to grant the Defendant an equitable lien on the Automobile based upon mutual mistake, the Defendant still could not prevail in this action. It is true in Tennessee that "[a] lien discharged by mistake is, in contemplation of equity, still in existence [and a] court of equity will keep alive or restore a lien where the equities of the case require it, and the parties intended that it should not be extinguished." *First Am. Nat'l Bank v. Miller (In re Miller)*, 286 B.R. 334, 341 (Bankr. E.D. Tenn. 1999) (citing *Jetton v. Nichols*, 8 Tenn. App. 567, 1928 WL 2152 at *5 (Tenn. Ct. App. 1928)). Nevertheless, a "court of equity will not reform a written instrument even upon a showing of mutual mistake if the rights of innocent third parties have intervened." *Miller*, 286 B.R. at 341. Accordingly, even if the Defendant were granted an equitable lien, it would be an unsecured equitable lien, and the Trustee would still prevail by virtue of Tennessee Code Annotated section 47-9-102(a)(52), which accords the Trustee

with the status of a lien creditor. The case presently before the court further differs from the *Wilson* case relied upon by the Defendant in that the *Wilson* deed of trust was mistakenly released after the debtor had initially filed a Chapter 13 case, which was then converted to Chapter 7 after the release, and the court held that the trustee's rights were determined as of the date upon which that debtor filed her Chapter 13 bankruptcy case, not the date of conversion.[4] *See Wilson*, 261 B.R. at 667-68.

If the Defendant had never released its lien on the Original Certificate of Title, but instead had simply applied to the State of Tennessee for a corrected certificate of title, there would be no break in the chain of title, and the Defendant's post-petition correction would not be a transfer because the security interest would have remained perfected throughout the entire process;[5] or, if the Defendant had released its lien on the Original Certificate of Title on January 30, 2003, and on that same day, filed its Application with the State of Tennessee, perfection would relate back to the day upon which the Application was filed, i.e., January 30, 2003, and there would be no break in the chain of title. *See, e.g., Farmer v. Sovran Bank (In re Farmer)*, No. 03-3045, (Bankr. E.D. Tenn. filed Dec. 11, 2003).

For reasons of its own, the Defendant chose to release its lien on the Original Certificate of Title and to re-perfect that lien by proceeding for a second time with the title

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[4] In view of the court's determination that the Defendant's attempted perfection of its lien on the Revised Certificate of Title is avoidable by the Trustee under § 549, these observations by the court amount to nothing more than dicta.

[5] *See infra* note 6.

application and registration process required by Tennessee Code Annotated section 55-3-126(b)(1).[6]

Unfortunately for the Defendant, during that six-day post-petition time period of "imperfection," the Automobile was property of the bankruptcy estate. *See* 11 U.S.C.A. § 541(a) (Property of the estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case."). The Defendant's Application, filed post-petition, violated the automatic stay. Furthermore, the lien obtained thereby is subject to avoidance by the Trustee pursuant to § 549(a). Although it seems a harsh result, because of the Defendant's ill-fated choice of methods for correcting the Original Certificate of Title and its unfortunate timing, the Defendant has lost its security interest in the Automobile.[7]

The Defendant has some recourse, however, as it appears that the Debtor, notwithstanding that the Automobile remained property of the bankruptcy estate that the Trustee had not abandoned as a burdensome asset, executed and filed a Reaffirmation Agreement on March 25, 2003, whereby she reaffirmed her entire pre-petition obligation to

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[6] Section 55-3-126(b) requires perfection of a security interest "by delivery to the division of motor vehicles or the county clerk of the existing certificate of title . . . and an application for a certificate of title . . . ." This is exactly what the Defendant did on February 5, 2003. The appropriate procedure upon discovery of an error on the certificate of title by the owner or lienholder is to circle the incorrect information in red and write the correct information in red near the incorrect information. The Tennessee Department of Safety will then issue a new correct title. *See* TENNESSEE DEPARTMENT OF SAFETY, TITLE AND REGISTRATION: FREQUENTLY ASKED QUESTIONS, *available at* http://www.tennessee.gov/safety/title.html.

[7] Under 11 U.S.C.A. § 551, "[a]ny transfer avoided under section . . . 549 . . . is preserved for the benefit of the estate but only with respect to property of the estate." 11 U.S.C.A. § 551 (West 1993). "These events are meaningful in and of themselves and necessitate no additional 'recovery' by the Plaintiff [under § 550]." *Hendon v. G.E. Capital Mortgage Servs., Inc. (In re Carpenter)*, 266 B.R. 671, 676 (Bankr. E.D. Tenn. 2001); *see also Suhar v. Burns (In re Burns)*, 269 B.R. 20, 26 (B.A.P. 6th Cir. 2001) ("[A] trustee need not pursue recovery of property from the transferee if avoidance alone is an adequate remedy.").

the Defendant of $17,589.11.[8] Moreover, the Defendant will have an allowed unsecured claim in the amount of $17,323.99, less any payments received under the Reaffirmation Agreement. As such, the Defendant can expect to be included in the Trustee's distribution of assets to unsecured creditors.

A judgment consistent with this Memorandum will be entered.

ENTER: April 16, 2004

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

[8] Interestingly, the Defendant's Proof of Claim was filed for $17,323.99, an amount less than was reaffirmed by the Debtor.

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Debtor

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Plaintiff

v. Adv. Proc. No. 03-3187

AMERICAN HONDA FINANCE CORPORATION

Defendant

J U D G M E N T

For the reasons set forth in the Memorandum filed this date, it is ORDERED, ADJUDGED, and DECREED as follows:

1. The Motion for Summary Judgment filed by the Defendant on April 2, 2004, is DENIED.

2. The Motion for Summary Judgment filed by the Plaintiff on March 8, 2004, is GRANTED.

3. The Defendant's lien encumbering the 2002 Honda Accord purchased by the Debtor on September 9, 2002, is avoided pursuant to 11 U.S.C.A. § 549(a) (West 1993).

4. The trial of this adversary proceeding scheduled for May 4, 2004, is STRICKEN.

ENTER: April 16, 2004

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE